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# New York Provides Guidance on Cloud Computing Infrastructure as a Service

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Summary by taxanalysts®

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The opinion was issued for a company that offers remote access to Internet infrastructure, allowing customers to purchase increasable computing capacity to use for running Internet applications and programs. This is accomplished through the taxpayer using its physical data centers' computing capacity to generate on-demand virtual instances that operate as though the customer were using its own in-house hardware.

In order to use the remote computing infrastructure, customers must use operating system software and other applications to interact with their computing sessions. The taxpayer provides computing sessions using different operating systems at varying hourly prices. Sessions running open-source operating systems accrue at no additional charge, while sessions using third-party proprietary operating systems, such as Microsoft Windows, have a higher hourly cost. The price differences are not separately stated, and the taxpayer does not sublicense the operating systems to its customers.

Customers use the operating systems to install their own software, move their own files and

data onto the computing session, and use some standardized available software applications provided by the taxpayer.

The department's analysis addressed whether the sale of this remote computing power and its component software systems is subject to New York's sales tax, but it did not address data transfer fees that the taxpayer charges customers for uploading and downloading data to the remote computing sessions.

The department said that the operating systems that the taxpayer provides to operate its computing sessions constitute prewritten software, and by giving customers the ability to use the operating systems, the taxpayer was transferring a right to use prewritten computer software. That would ordinarily subject those transactions to sales tax.

However, the department said, "a customer does not subscribe to Petitioner's Cloud Computing product in order to use the operating system." Instead, the true purpose of each transaction is for a customer to obtain the right to use the taxpayer's computing power to run applications.

The transfer of the right to use operating system software, and any other applications provided in computing sessions, is only an incidental part of the taxpayer's product, the department said.

Ultimately, because New York law stipulates what services are subject to sales tax, and providing computing services is not one of those expressly taxed services, the taxpayer's cloud computing infrastructure transactions are not subject to the state sales tax, the department said.

Jeffrey Reed of Mayer Brown LLP said that the ruling, coupled with previous rulings on the taxability of software transactions (including TSB-A-08(62)S) and electronic messaging services (such as *In re Easylink Services Int'l Inc. v. New York State Tax Appeals Tribunal*), give insight into the department's analytical approach to cloud computing transactions.

Reed said that New York will first examine what the customer is really buying, and whether the customer is purchasing or accessing software. If the answer is yes in either case, the department will ask whether the customer's principal purpose is to receive the software, who is providing it, and whether it is incidental to the transaction, he said.

The department's next question will be whether the transaction involves some type of electronic service that a customer is paying for and whether that service is taxable as telephony and telegraphy, like e-mail and electronic messaging services, Reed added.

Overall, Reed said, "in the context of cloud computing and products accessed electronically, the department is drilling down to ask what the customer is really paying for and is considering whether payment is principally for software, or telephony or telegraphy, or something else."

Kelley Miller of Reed Smith LLP said the department did a good job of determining that the customer was actually paying for access to computing power, not the incidental things whose use may be necessary to access that platform.

If a customer is using this type of service to have the computing capacity to run an e-

commerce website, it may take software to use the computing session and to put information onto a vendor's system, Miller said. However, she added, "what the customer really needs here is the capacity to host and operate its application or platform."

Michele Borens of Sutherland Asbill & Brennan LLP said that in many states, "they see 'software' and it taints the whole transaction even though that may not be what the customer is really after."

She said it was good to see that the New York taxation department was not just focused on the fact that software was provided to use the taxpayer's service but was also interested in understanding what the customer was seeking in those types of transactions. That treatment is consistent with guidance other states have provided on infrastructure as a service transactions, she added.

Carolynn Iafrate Kranz of Kranz & Associates PLLC said she was pleasantly surprised by the department's position in its ruling, but she noted that its analysis may contradict its software-as-a-service rulings.

"In regards to software as a service, New York's position is that that is the taxable sale of software, because a customer exercises constructive ownership, custody, use, possession, or control over the software -- software that a customer never physically touches, never physically receives, and is not physically downloaded to their computer," she said.

"It is interesting that that is their position on software as a service, yet on infrastructure as a service, where a customer is using computing power -- essentially computer hardware -- which is also tangible personal property, they are not attempting to argue constructive ownership, possession, custody, use, or control," she said. That, Kranz said, would be the wrong argument to make, and because of that, she applauded New York for coming up in this case with the right answer.

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## Tax Analysts Information

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